SCOTT PAPER LIMITED ANNUAL REPORT 1977

Contents

Scott Paper Limited
1977 Annual Report

Head office/Vancouver, British Columbia
Plants/New Westminster and Surrey,
British Columbia and Crabtree, Quebec
Sales offices/Vancouver, Winnipeg, Toronto,
Montreal and Dartmouth, Nova Scotia

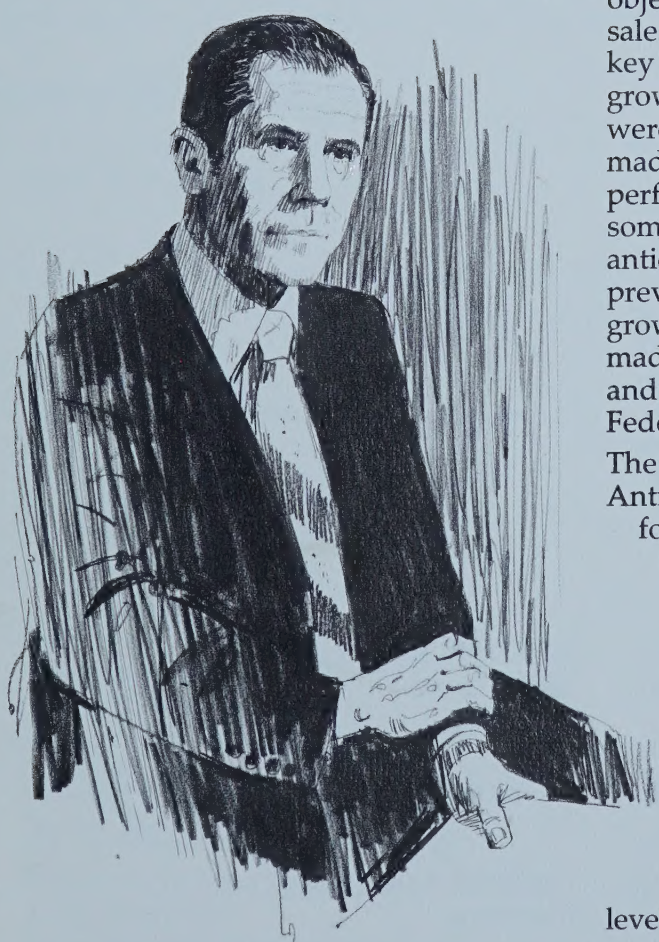
Valuation Day Value

For Canadian capital gains tax purposes, valuation day values of Scott Paper Limited securities are as follows:

Common Shares ....$ 18.50
1971 Series A Debentures $102.00

Ce rapport annuel est publié en français et en anglais.
Si vous désirez en obtenir un exemplaire additionnel, prière d'aviser le Secrétaire.

To our Shareholders and Employees



For the year 1977, net sales increased by 4.5%, from $99,431,000 to $103,884,000. Net income after taxes increased by 2.6%, rising from $3,565,000 to $3,659,000. Earnings per share were $4.57 versus $4.46 for the prior year. More detailed financial information is included in the Review of the Year, which follows.

While this improvement over 1976 was not up to our objectives for the year, under the circumstances sound sales and financial progress was achieved. Case sales of all key product lines increased at a rate comparable to market growth and shipments of bathroom tissues and towels were particularly encouraging. Manufacturing operations made a very positive contribution to our financial performance, as productivity increased and the costs of some purchased materials and supplies were less than anticipated. However, very intense price competition was prevalent throughout the year, and this factor curtailed the growth of sales revenues, offsetting some of the gains made in other areas. The sluggish and uncertain economic and political conditions, high unemployment and the Federal Anti-Inflation program also affected 1977 results.

The Federal Government has announced that the current Anti Inflation Control Program will end in 1978. We look forward to the termination of these controls. Their implementation did have a positive effect on lowering the expectations that the Canadian economy could provide but have also had a negative impact on the business climate and attitude toward investment in the private sector. Certainly, with the phase-out of A.I.B. will come the absolute need for the Federal and Provincial Governments to show a good example in lowering the overall cost of government, and for labour and management to show realistic expectations from the economy for wage and price increases if we are to avoid the levels of inflation that existed in 1972 through 1975.

The current G.A.T.T. negotiations which could result in a lowering of certain tariff protection on Canadian produced products is another major reason why Canadian secondary industry should improve its cost competitiveness.

At Scott Paper Limited, concentration continued on cost control, efficiency measures and future planning. Some changes in organization took place in order to broaden the scope of this program, to improve control of inventory levels and logistics services and to provide more sophisticated financial planning techniques. A number of important cost saving and profit improvement opportunities have been realized in recent years as a result of increased concentration on planning. It is our intention to focus even more attention on this important activity in the future.

On May 13th, we were saddened by the death of Renault St-Laurent. Mr. St-Laurent joined our Board of Directors in 1963, and he made many important contributions to the development of the company, particularly related to the acquisition of the Eastern Manufacturing Division at Crabtree, Quebec.

Mr. Chester A. Johnson was appointed a director on December 9, 1977. Mr. Johnson is Chief Executive Officer of Whonnock Industries Limited and is very active in the Western Canadian forest products industry. We welcome Mr. Johnson to the company and look forward to a long and fruitful association.

1977 marked the twentieth anniversary of the acquisition of our plant at Crabtree, Quebec. Acquired in the fall of 1957, the plant consisted of two paper machines, a groundwood mill and a small converting operation, and there were approximately 250 employees. Since then, employment has increased to almost 900, there are four paper machines, a modern high-speed converting operation, and the mechanical pulp mill has recently been replaced with a secondary fibre operation.

The company has a long history in both communities in which its plants are located — Crabtree, Quebec and New Westminster, B.C. — well over 50 years in each one. Our good relationships with our neighbours there are an important contributor to our progress.

One of the main strengths of our company over the years has been the strong and durable relationships we have enjoyed with our employees, suppliers and customers. Our thanks to all for their high-spirited support and cooperation during the year.

FOR THE BOARD OF DIRECTORS,

George L. O'Leary

GEORGE L. O'LEARY
Chairman

Review of the Year

Scott Sales and Marketing Divisions were active with the introduction of both new and improved products in all regions of the country.

The introduction of new Cottonelle bathroom tissue in Eastern Canada was completed with the addition of the Maritimes provinces to the sales area. Shipments of Cottonelle in the original introductory regions, Ontario and Quebec, continued at strong levels. Baby Fresh, a new pre-moistened infant tissue packaged in an attractive molded plastic container, was introduced into test market in southwestern Ontario.

Two national consumer product introductions were completed. New packaging and package graphics were developed for Lady Scott decorated facial and bathroom tissue, and Beltless Confidets feminine napkins were introduced. Confidets, which was the first anatomically shaped feminine napkin, has been redesigned and repackaged in order to take advantage of significant new trends in the market for feminine protection products.

The Industrial Packaged Products Division faced very active price competitive market conditions throughout the year. However, the introduction of new Cottonelle tissue in our eastern industrial sales division had very positive effects upon our sales operation there and by year end, shipments of our key product lines, towels and bathroom tissues, were running well ahead of 1976 all across the country.

Manufacturing had a good year. There was significant progress with cost control and productivity programs and important new opportunities were realized with the start-up of new operations in the pulping and fibre recovery areas at both Crabtree and New Westminster.

Financial Highlights

FOR THE YEAR	1977 (thousands of dollars except per share)	1976	Percent Change
Net Sales	$103,884	$ 99,431	4.5
Depreciation	3,831	3,869	(1.0)
Interest expense	2,471	2,306	7.2
Income before taxes	5,674	6,143	(7.6)
per share	7.09	7.68	
Income taxes	2,015	2,578	(21.8)
Income after taxes	3,659	3,565	2.6
per share	4.57	4.46	
Dividends	1,040	960	8.3
per share	1.30	1.20	
Income reinvested in the business	2,619	2,605	0.5
Cash flow from operations	9,373	8,983	4.3
per share	11.71	11.23	
Capital expenditures	9,813	7,589	29.3
Salaries, wages and benefits	27,898	27,239	2.4
AT YEAR END			
Ratio current assets to current liabilities	1.6	1.9	
Long term debt	$ 20,354	$ 21,464	
Shareholders' interest per share	$ 40.26	$ 36.99	
Number of shares outstanding at year end	800,500	800,000	
Number of shareholders	991	1,024	
Number of employees	1,554	1,589	
Investment in assets per employee	$ 40	$ 37	

The new secondary fibre operation which has replaced our groundwood pulp mill at Crabtree commenced operations during the fall. This process recovers kraft pulp fibre from waste paper and has several important advantages over the mechanical pulp formerly produced there.

The Western Manufacturing

Division experienced successful start-ups of a new log waste chipping operation and of additions to the effluent control system. The additions to the effluent system consist of two Krofta flotation cells which enable the Western Manufacturing Division to comply with the latest level A requirements of the Provincial Government. Significant reduction of paper mill fibre loss is also expected from the Krofta cells and the chipper virtually eliminates log waste in our groundwood pulp process.

New converting operations were also placed in operation at Crabtree and New Westminster.

As a result of programs established previously, accident and safety rates improved during 1977. These programs were augmented during the year and include special facilities for noise level analysis and testing which have been particularly advantageous. Fire protection systems in both plants were substantially renewed, including the provisions of a secondary water supply in New Westminster.

Two-year labour agreements were negotiated with the Canadian Paperworkers Union, representing employees of the Western Manufacturing Division, and Le Syndicat National des Travailleurs des Pâtes et Papiers de Crabtree, Inc. Both agreements are within A.I.B. guidelines and the Crabtree agreement includes provision for a wage re-opener in the second year. A one-year agreement was concluded with the Office and Technical Employees Union which represents our clerical staff at Vancouver and New Westminster.

There were 1,554 employees in the company at

year end, of which over 18% have 20 years of service or more.

Although 1977 was a very challenging year, the company again set a record in sales and income after taxes. Sales of $103,884,000 were 4.5% over sales of $99,431,000 in 1976. Income after taxes of $3,659,000 increased 2.6% over the $3,565,000 earned in 1976. Although some modest price increases were instituted on certain products, very little was actually realized as a result of the price competition in the market place.

In addition, the company absorbed all costs related to the introduction of new products in 1977, Beltless Confidets nationally and Baby Fresh wipes in the Ontario market. The costs and expenses related to the start-up of our secondary fibre installation at Crabtree were also included in cost of sales for the year.

The company benefited from a lower effective tax rate in 1977 — 35.5% versus 42% in 1976. This lower tax rate was due to investment tax credits arising from greater investment spending in plant and equipment during 1977 than in the previous year and the 3% inventory tax credit instituted by the Federal Government. This latter tax credit was provided to offset, to some extent, the taxation on profits that are solely due to prevailing inflation rates.

Once again, due to delays in construction and deliveries of equipment, the investment of $9.8 million in facilities in 1977 was somewhat less than the $12 million originally estimated. In 1978, we expect capital expenditures to be about $6 million, including the carry-over from 1977. These capital additions will be entirely financed by the cash flow of the company. Due to the 1977 capital expenditure, $1,817,000 was added to the deferred tax account for the year, which increased our cash flow and assisted in funding the expenditures program.

The issued share capital of the company increased by 500 shares in 1977 due to the exercising of share options. In this, our 47th consecutive year of dividend payments, the dividend rate on the common shares was $1.30 per share for the year, compared to $1.20 in 1976, the maximum increase allowed under A.I.B. controls.

Consolidated Statements of Income and Retained Income

Year ended December 31

	1977	1976
	(in thousands)	
INCOME:		
Sales, less allowances and after deducting Federal sales tax of $9,319,000 (1976 — $8,786,000)	$103,884	$99,431
EXPENSES (Note 7):		
Cost of products sold	72,234	68,876
Selling and distribution expenses	19,728	18,206
Administrative and general expenses	3,777	3,900
Debenture interest and amortization of issue costs	2,220	2,224
Bank interest	251	82
	98,210	93,288
Income before income taxes	5,674	6,143
INCOME TAXES:		
Current	198	1,066
Deferred	1,817	1,512
	2,015	2,578
Income for the year	$ 3,659	$ 3,565
Income per share	$4.57	$4.46
RETAINED INCOME:		
Retained income at beginning of year	$ 22,995	$20,390
Income for the year	3,659	3,565
	26,654	23,955
Dividends — $1.30 per share (1976 — $1.20 per share)	1,040	960
Retained income at end of year	$ 25,614	$22,995

Consolidated Statement of Financial Position

	December 31	
	1977	1976
	(in thousands)	
CURRENT ASSETS:		
Cash	$ 36	$ 37
Trade and other accounts receivable	8,926	6,669
Income taxes recoverable	209	—
Inventories (Note 2)	24,377	24,328
Prepaid expenses	179	181
	33,727	31,215
CURRENT LIABILITIES:		
Bank indebtedness (Note 3)	12,192	4,915
Accounts payable and accrued liabilities	8,644	11,133
Income taxes payable	—	464
Current portion of long term debt (Note 5)	770	—
	21,606	16,512
Working capital	12,121	14,703
Add: NON-CURRENT ASSETS —		
Fixed assets (Note 4)	49,106	43,170
Unamortized debenture discount and issue expenses	431	476
Miscellaneous assets	300	271
	49,837	43,917
Deduct: NON-CURRENT LIABILITIES —		
Sinking fund debentures (Note 5)	20,354	21,464
Deferred income taxes (Note 1(d))	9,378	7,561
	29,732	29,025
Net assets	$32,226	$29,595
SHAREHOLDERS' INTEREST:		
Share capital (Note 6)	$ 6,612	$ 6,600
Retained income (Note 5)	25,614	22,995
	$32,226	$29,595

APPROVED BY THE BOARD OF DIRECTORS:

G. L. O'Leary
Director

A. W. Fisher
Director

Notes to Consolidated Financial Statements December 31, 1977

1. Summary of significant accounting policies:

(a) Principles of consolidation —

The consolidated financial statements include the accounts of Scott Paper Limited and its wholly-owned subsidiaries, Westminster Paper Company Limited, operating, and Omega Products Limited, non-operating.

All intercompany transactions are eliminated.

(b) Inventories —

Inventories of finished products and work in process are valued at the lower of average cost and market value determined on the basis of net realizable value. Raw materials and supplies are valued at average cost which is not in excess of replacement cost.

(c) Depreciation and amortization —

Fixed assets —

Depreciation is provided on buildings, machinery and equipment on a straight-line basis over their estimated useful economic lives at rates ranging from 2½% to 20% of original cost per annum.

Debenture discount and issue expenses —

The amortization of debenture discount and issue expenses is provided on a basis related to the principal amount outstanding.

(d) Income taxes —

On January 1, 1968 the Company adopted the tax allocation method of accounting for income taxes for all periods subsequent to that date.

Subsequent to January 1, 1968, the Company has provided for deferred income taxes arising primarily from claiming capital cost allowances available for income tax purposes in excess of depreciation charged to operations.

Prior to January 1, 1968 the Company followed the policy of charging against earnings only income taxes actually payable after claiming maximum capital cost allowances available for income tax purposes on its fixed assets. Because capital cost allowances exceeded depreciation provided in the financial statements for those years, there are accumulated reductions in income taxes otherwise payable of approximately $3,902,000 which have not been recorded as deferred income taxes.

The Company follows the practice of recognizing the investment tax credit currently as a reduction of income tax expense.

(e) Interest capitalization —

Interest incurred during construction of major capital projects is capitalized. A major capital project undertaken at the Company's Eastern Manufacturing Division at a cost of approximately $5,000,000 was substantially completed by December 31, 1977. This project was financed through bank borrowings resulting in interest capitalized of approximately $250,000 in 1977.

2. Inventories:

Inventories consist of —

	December 31 1977	1976
	(in thousands)	
Finished products and work in process	$16,624	$15,828
Raw materials and supplies	7,753	8,500
	$24,377	$24,328

3. Bank indebtedness:

The bank indebtedness includes unpresented cheques and is secured by a pledge of the Company's accounts receivable and inventories.

4. Fixed assets:

Fixed assets consist of —

	December 31 1977	1976
	(in thousands)	
Land, at cost	$ 544	$ 527
Buildings, machinery and equipment, at cost	80,794	72,090
Less: Accumulated depreciation	32,232	29,447
Net book value of depreciable assets	48,562	42,643
	$49,106	$43,170

During 1977 the Company entered into an agreement which provided for the Quebec Industrial Development Corporation to assume interest costs of approximately $100,000 per annum for five years in connection with the financing of the secondary fibre facility at the Company's Eastern Manufacturing Division. This subsidy is subject to a number of conditions with which the Company is complying. The agreement provides for the subsidy to commence on completion of the project, and accordingly no funds were received or accrued in 1977.

5. Sinking fund debentures:

	December 31			
	1977			1976
	8¾% Series A	11⅝% Series B (in thousands)	Total	Total
Principal amount issued	$12,000	$11,000	$23,000	$23,000
Principal amount outstanding	$10,124	$11,000	$21,124	$21,464
Less: Payments due within one year	—	770	770	—
	$10,124	$10,230	$20,354	$21,464

8¾% sinking fund debentures, series A —
The Series A debentures were issued on July 2, 1971 with a maturity date of July 2, 1991 and require that mandatory sinking fund payments be made in each of the years 1974 to 1990 to retire $360,000 of the debentures per annum with an option to retire a further $180,000 per annum.

11⅝% sinking fund debentures, Series B —
The Series B debentures were issued on December 9, 1975 with a maturity date of October 31, 1990 and require that mandatory sinking fund payments be made in each of the years 1978 to 1989 to retire $770,000 of the debentures per annum.

The trust agreement contains a distribution test formula which limits the availability of retained income for payment of dividends. As of December 31, 1977 approximately $9,200,000 is available for distribution under the most restrictive tests.

Minimum sinking fund payments required in each of the five years following December 31, 1977 is as follows —

1978	$ 770,000*
1979	$1,054,000*
1980	$1,130,000
1981	$1,130,000
1982	$1,130,000

**Net of amounts acquired and lodged for future sinking fund requirements.*

6. Share capital:

The authorized share capital of Scott Paper Limited consists of 2,000,000 common shares without par value of which 800,500 are issued and outstanding.

Of the 1,199,500 unissued shares, 49,500 are reserved for options under the "Key Employees' Stock Option Plan". As at December 31, 1977, options to purchase 45,500 shares are outstanding (but not yet exercised) at a price of $24.00 per share, valid to October 23, 1981. Options to purchase 500 shares at $24.00 were exercised in 1977.

7. Expenses include:

	December 31	
	1977 (in thousands)	1976
Depreciation	$ 3,831	$ 3,869
Directors' and senior officers' remuneration	$ 427	$ 502

8. Pension plans:

The Company's hourly employees at the Western Manufacturing Division are members of an industry pension plan to which the Company contributes. In addition, the Company has a number of contributory pension plans, participation being available to substantially all of its other employees. Length of service and individual earnings determine the pensions and retirement benefits for all members of the Company plans. It is the Company's practice to provide for its portion of the cost of pensions and retirement benefits accrued, through charges to earnings determined by periodic actuarial computations. Actuarial reports as of December 31, 1976 revealed that the Company plans were fully funded.

9. Anti-Inflation Program:

The Company and its operating subsidiary are subject to, and have complied with, controls on prices, profits, compensation and dividends under the federal governments' Anti-Inflation Program. Under the present anti-inflation legislation, dividends during the compliance year ended October 13, 1978 may not exceed $1.37 per share.

Consolidated Statement of Changes in Financial Position

	Year ended December 31	
	1977	1976
	(in thousands)	
Financial resources were provided by:		
Operations —		
Income for the year	$ 3,659	$ 3,565
Items which did not involve an outlay of working capital —		
Depreciation	3,831	3,869
Deferred income taxes	1,817	1,512
Amortization of debenture issue costs	45	45
(Gain) loss on disposal of fixed assets	21	(8)
	9,373	8,983
Issue of common shares	12	—
Proceeds on disposal of fixed assets	25	38
	9,410	9,021
Financial resources were used for:		
Additions to fixed assets	9,813	7,589
Dividends	1,040	960
Reduction of long term debt	1,110	169
Increase in miscellaneous assets	29	26
	11,992	8,744
Increase (decrease) in working capital during the year	(2,582)	227
Working capital at beginning of year	14,703	14,426
Working capital at end of year	$12,121	$14,703

Auditors' Report

1075 West Georgia Street
Vancouver, B.C.
February 16, 1978

To the Shareholders of
Scott Paper Limited:

We have examined the consolidated statement of financial position of Scott Paper Limited as at December 31, 1977 and the consolidated statements of income and retained income and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse & Co.
Chartered Accountants

Ten Year Review

	1977	1976	1975	1974	1973	1972	1971	1970	1969	1968
					(thousands of dollars except Per Share)					
Sales and Earnings										
Net sales	**$103,884**	99,431	84,629	73,571	56,295	48,118	42,910	39,762	35,789	34,133
Depreciation	**3,831**	3,869	3,286	3,008	2,394	2,031	1,780	1,426	1,312	1,223
Interest expense	**2,471**	2,306	2,115	1,220	1,099	1,103	879	448	334	211
Income before taxes	**5,674**	6,143	5,404	5,523	3,538	3,244	3,049	3,183	3,268	3,020
Income taxes	**2,015**	2,578	2,445	2,586	1,544	1,557	1,463	1,600	1,700	1,585
Income after taxes	**3,659**	3,565	2,959	2,937	1,994	1,687	1,586	1,583	1,568	1,435
Per Share										
Income before taxes	**$ 7.09**	7.68	6.76	6.90	4.42	4.06	3.81	3.98	4.09	3.77
Income after taxes	**4.57**	4.46	3.70	3.67	2.49	2.11	1.98	1.98	1.96	1.79
Cash flow	**11.71**	11.23	9.63	9.31	7.02	5.33	4.90	4.75	3.89	3.39
Dividends paid	**1.30**	1.20	1.20	1.00	1.00	.95	.90	.90	.90	.80
Shareholders' Equity	**40.26**	36.99	33.74	31.24	28.57	27.08	25.92	24.83	23.75	22.69
Number of shares outstanding (thousands)	**800.5**	800.0	800.0	800.0	800.0	800.0	800.0	800.0	800.0	800.0
Condensed Funds Statements										
Source of funds										
— operations	**$ 9,373**	8,983	7,705	7,447	5,619	4,266	3,918	3,799	3,070	2,658
— long term financing and other	**37**	38	10,892	58	429	55	11,482	2,804	2,642	56
	9,410	9,021	18,597	7,505	6,048	4,321	15,400	6,603	5,712	2,714
Expenditures for										
— fixed assets	**9,813**	7,589	7,056	7,816	5,677	3,087	3,376	6,701	4,797	2,188
— dividends	**1,040**	960	960	800	800	760	720	720	720	640
— reduction of long term borrowings and other	**1,139**	195	13	763	608	—	6,100	—	—	321
	11,992	8,744	8,029	9,379	7,085	3,847	10,196	7,421	5,517	3,149
Net increase (decrease) in working capital	**$ (2,582)**	277	10,568	(1,874)	(1,037)	474	5,204	(818)	195	(435)
Financial Position										
Current assets	**$ 33,727**	31,215	25,960	23,416	13,974	13,248	12,990	11,113	10,493	9,067
Current liabilities	**21,606**	16,512	11,534	19,558	8,242	6,479	6,695	10,022	8,584	7,353
Working capital	**12,121**	14,703	14,426	3,858	5,732	6,769	6,295	1,091	1,909	1,714
Fixed assets at net book value	**49,106**	43,170	39,480	35,740	31,031	28,206	27,206	25,610	20,334	16,849
Long term debt	**20,354**	21,464	21,633	10,636	11,400	12,000	12,000	6,100	3,300	700

Officers and Executive Management

GEORGE L. O'LEARY
Chairman, President & Chief Executive Officer

THOMAS J. BIRKENHEAD
Controller

JAMES C. BOYLE
Assistant Vice President (Industrial Marketing)

W. MICHAEL FERRIE
Assistant Vice President
(Director of Corporate Personnel)

JAMES L. GLANVILLE
Corporate Planning Manager

BERNARD A. GOULET
Vice President (Manufacturing)

SERGE GUAY
General Manager, Eastern Manufacturing Division

JOHN J. HERB
Secretary, Scott Paper Limited
Vice President, Westminster Paper Company Limited

DOUGLAS HOLME
Vice President (Corporate Development)

NORMAN A. KELLY
President, Westminster Paper Company Limited

RALPH M. KITOS
General Manager, Western Manufacturing Division

J. CORTLAND LANGE
Consumer Marketing Manager

WILLIAM M. MATTICE
Director of Quality Control

PETER J. PETERS
Vice President (Finance) and Treasurer

JOHN F. PHILIP
Assistant Vice President
(Ventures and Product Development)

H. PETER SANAGAN
Vice President (Marketing)

R. D. BRUCE SHELLY
Director of Logistics

DAVID H. STOWE
Assistant Vice President
(Director of Consumer Sales)

Board of Directors

H. CLARK BENTALL*
Chairman and Chief Executive Officer
Dominion Construction Company Limited
Vancouver, B.C.

GILBERT C. CLARKE
Deputy Chairman of the Board
Standard Brands Limited, Montreal, P.Q.

ALEX W. FISHER, Q.C.†
Associate Counsel, Davis & Company
Barristers & Solicitors, Vancouver, B.C.

W. DOUGLAS H. GARDINER†
Vice Chairman
The Royal Bank of Canada, Toronto, Ontario

CHESTER A. JOHNSON†
President
Whonnock Industries Limited
Vancouver, B.C.

GEORGE L. O'LEARY*†
Vancouver, B.C.

PETER J. PETERS*
Vancouver, B.C.

JAMES D. STOCKER*
Vice President & Director
Scott Paper Company, Philadelphia, Pa.

*Member of the Executive Committee.
†Member of the Audit Committee.

Transfer Agent and Registrar

THE CANADA TRUST COMPANY
Vancouver, Calgary, Toronto, Montreal and Halifax

Stock Listings

Vancouver, Toronto and Montreal Stock Exchanges

Annual Meeting

The Company's Annual Meeting of Shareholders will be held at 11:30 a.m. on April 21, 1978 at the Four Seasons Hotel, Vancouver, B.C.

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TO OUR SHAREHOLDERS AND EMPLOYEES

For the first half of 1977, net sales increased by 8.0% to $55,750,000, and net income after taxes rose by 7.2% to $1,900,000, or $2.38 per common share. The rate of growth in sales improved over that reported for the first quarter, reflecting stronger overall performance by our consumer product lines. Economic conditions, which are still weak in Canada, continued to adversely affect sales to industrial and commercial customers and distributors. The overall favourable results were achieved by our people under very competitive conditions.

Growth in earnings after taxes is attributable to an improvement in the rate of income tax applicable for the year 1977. Our capital spending programs have enabled the company to take full advantage of investment tax credits, reducing the tax rate to 40% from the 46% rate applicable to the same period in 1976. Cost of products sold during the period decreased as a percentage of sales, but this contribution was more than offset by increases in freight, shipping and storage costs. Interest expenses have also increased. This relates to our capital spending program from which there will be future benefits, and to higher inventories required to support increased sales. The overall effect of these factors was an increase in the costs of operations resulting in a decline in profit before taxes.

Our first quarter report stated that an application to increase prices to cover cost increases had been filed with the Anti-Inflation Board. This application has been approved — the price inceases were announced in June and the favourable effects should be reflected in the last half of 1977.

On Friday, May 13th, we were saddened by news of the death of Mr. Renault St-Laurent, of Quebec City. Mr. St-Laurent had been a director of the company since October 11, 1963, and his counsel and enthusiastic support will be greatly missed.

For the Board of Directors

George O'Leary
G. L. O'Leary
Chairman

Vancouver, B.C.
July 18, 1977

SCOTT PAPER LIMITED
Box 3600, Vancouver, B.C. V6B 3Y7

Printed in Canada

SCOTT

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SCOTT PAPER LIMITED

REPORT TO THE SHAREHOLDERS
For the First Six Months of 1977

SCOTT PAPER LIMITED

CONSOLIDATED STATEMENT OF INCOME

(in thousands except on a per share basis)

	First Six Months 1977	*First Six Months 1976*
Sales, less discounts and allowances	$55,750	$51,638
Expenses (Note 1):		
Cost of products sold	39,188	36,557
Marketing, general, administrative and development expenses	12,088	10,692
Interest and amortization of debenture issue costs	1,305	1,106
	52,581	48,355
Income before taxes	3,169	3,283
Provision for taxes on income (Note 2)	1,269	1,510
Income after taxes for the period	$ 1,900	$ 1,773
Income per share after taxes	$2.38	$2.22
Dividends paid per share	.65	.60
Number of common shares outstanding	800,000	800,000

Note 1 – Expenses include depreciation of $2,157 (1976 – $1,808).

Note 2 – Pending enactment of regulations regarding the proposed 3% deduction of opening inventory values from taxable income, included in the Canadian Federal Budget of March 31, 1977, it is estimated that the provision for taxes on income applicable to the first six months of 1977 would be reduced approximately $120,000.

Unaudited and subject to year end adjustment.

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF WORKING CAPITAL

(in thousands)

	First Six Months 1977	*First Six Months 1976*
SOURCE:		
Income for the period	$ 1,900	$ 1,773
Add — Charges which did not involve an outlay of working capital:		
Depreciation (Note 1)	2,157	1,808
Deferred income taxes	750	551
Amortization of debenture issue costs	22	21
Net decrease of miscellaneous items	19	2
	4,848	4,155
APPLICATION:		
Net additions to fixed assets	4,166	2,944
Dividends	520	480
Purchase of Series A debentures	—	89
	4,686	3,513
Increase in working capital during the period	162	642
Add — Working capital at beginning of the year	14,703	14,426
Working capital at end of the period	$14,865	$15,068